Economic Monitor

HOUSE COMMITTEE ON THE BUDGET
Majority Caucus • Jim Nussle, *Chairman*

309 Cannon House Office Building
www.budget.house.gov • (202) 226-7270

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RECENT DATA SHOW MODERATE GROWTH, AMID UNCERTAINTY

Key economic data released this week reinforce the view that the economy is continuing to recover, but the pace is not fast enough to create strong job growth.

The absence of strong, positive momentum in the economy appears to be contributing to uncertainties that have lingered since last year's recession and terrorist attacks. There also appear to be understandable concerns about international challenges and the shakeup in the stock market following the bubble of the late 1990s.

These conditions justify concern, but not pessimism – especially when viewed in a broader, historical context. Indeed, the state of the economy fits the pattern of a normal business cycle – albeit with a somewhat slower recovery following a milder-than-usual recession. The economy is expected to return to sustainable, long-term growth in 2003 and beyond.

Meanwhile, policies enacted by Congress and the President clearly helped keep the recession from being more severe, and are helping boost the recovery. These policies are well-designed to support growth in the future.

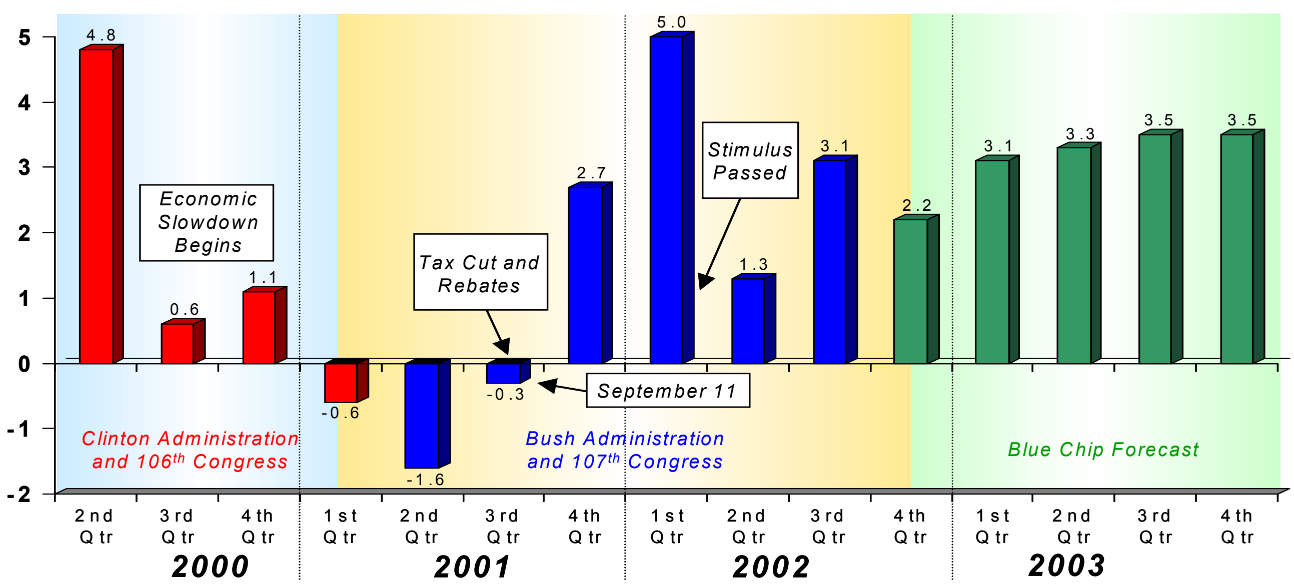
Recent Data

Data from the past week reflect the uncertainty of the economic picture.

- *Economic Growth* – The Commerce Department reported that real gross domestic product [GDP] grew 3.1 percent at an annual rate in the third quarter of this

GDP REBOUNDING FROM SLOWDOWN AND RECESSION OF 2000-01

Real GDP Growth at Annual Rate (Percentage)



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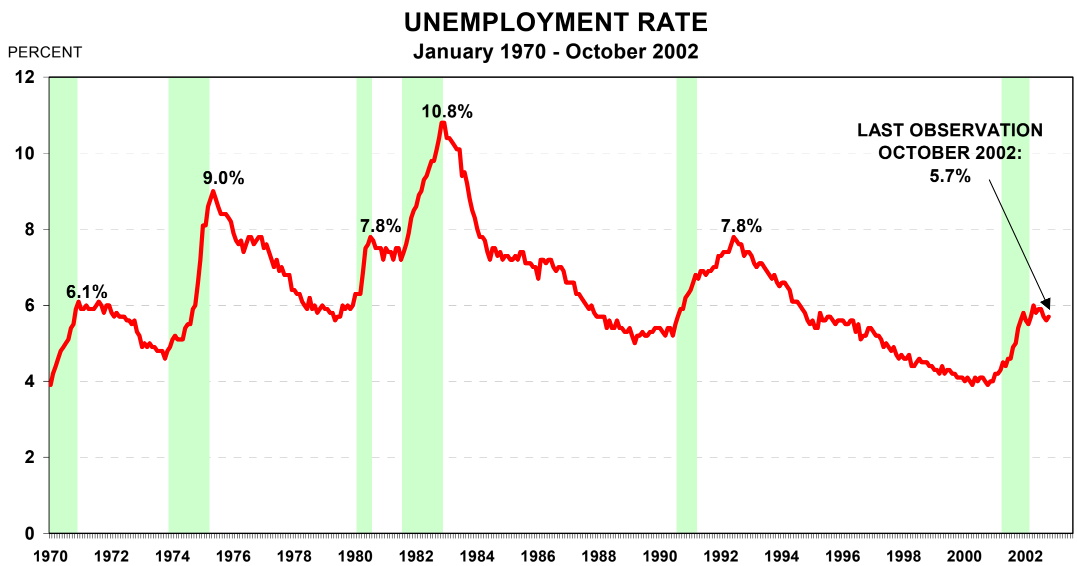
year, continuing the rebound from the economic slowdown and recession of 2000-01 (see chart on preceding page).

- *Unemployment* – The Labor Department reported that, in October, the unemployment rate was 5.7 percent and that nonfarm payroll employment was largely unchanged, declining slightly by 5,000 jobs. Initial claims for unemployment insurance also continue to track near 400,000, a level suggesting a sluggish labor market. The unemployment rate has hovered around 5¾ percent for several months, neither worsening nor improving convincingly – but at a lower rate than the highs following past recessions (see chart below).



Note: Shaded areas represent recession periods.

- *Manufacturing* – The Institute for Supply Management reported its purchasing managers index [PMI] was at 48.5 percent in October. (A value less than 50 percent indicates a contracting manufacturing sector; greater than 42.7 indicates the general economy is growing).

- *Consumer Confidence* – The Conference Board reported that consumer confidence – a volatile measure of consumer attitudes – fell in October to its lowest level in 9 years.

Financial markets showed a strong positive trend in recent weeks. The Dow Jones Industrial Average climbed 10.6 percent in October, its largest monthly gain since January 1987. The S&P 500 advanced 8.6 percent, its largest gain since March 2000. The Nasdaq grew 13.5 percent.

The Business Cycle

To view recent data and the behavior of the economy in recent years in the proper context, one must understand that they simply reflect the normal process of the business cycle.

A sudden drop in business investment spending, the shock from September 11, and the difficulties resulting from the bursting of the 1990s' stock market bubble were the primary contributors to the slowdown and recession – which began not in 2001, but early in 2000.

Partly because the recession was one of the mildest on record, the economy has recovered at only a slow to moderate rate – consistent with the recent data. Growth is occurring in an uneven fashion, and at a pace not fast enough to significantly boost key sectors and markets such as manufacturing and employment.

The Outlook Is Still Up

As noted from the outset, current economic uncertainties warrant concern, but not excessive pessimism. The distinction is important because it affects the policies Congress chooses in the future – and those choices can help or hinder the recovery.

It is critically important that Congress stick with the scheduled future income tax rate reductions from last year's tax cuts, as they will provide continued support for the economy. Most forecasters are confident that the combination of ongoing support from the income tax cuts, the investment tax incentives of the stimulus legislation, and the Federal Reserve's interest rate cuts – including additional rate cuts if necessary – will provide sufficient support for the recovery, and will return the economy to a path of sustained long-run growth.